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Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Institutional Cost Contribution
Requirement for Competitive Products

Docket No. RM2017-1

PUBLIC REPRESENTATIVE COMMENTS IN RESPONSE TO
ADVANCE NOTICE OF RULEMAKING TO EVALUATE THE INSTITUTIONAL COST
CONTRIBUTION REQUIREMENT FOR COMPETITIVE PRODUCTS

(January 23, 2017)

I. INTRODUCTION

On November 22, 2016, the Commission issued an Advance Notice of Proposed Rulemaking in this proceeding to evaluate the Postal Service's required institutional cost contribution for competitive products.[1] The rulemaking was initiated pursuant to the requirement of 39 U.S.C. § 3633(b), that every five years the Commission shall review **"**the institutional costs contribution requirement under subsection (a)(3) of section 3633.**"** Subsection (a)(3) requires the Commission to "ensure that all competitive products collectively what the Commission determines to be an appropriate share of institutional costs."

Pursuant to section 3633(b), the Commission must consider whether the appropriate share specified in the Commission's regulations "should be retained in its current form, modified or eliminated." To carry out the evaluation, section 3633(b) prescribes that "the Commission shall consider all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products."

[1] Advance Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, November 22, 2016 (Order No. 3624).

Order No. 3624 initiating this proceeding appointed the undersigned as Public Representative and requested comments from interested persons no later than January 23, 2017. Pursuant to that order, the Public Representative hereby submits the following comments.

II. SUMMARY OF PUBLIC REPRESENTATIVE RECOMMENDATION

The Public Representative has reviewed the Commission's previous notices and orders relating to the appropriate share of the Postal Service's institutional costs that should be borne by its competitive products. In addition, the Public Representative has considered market conditions and the prevailing competitive conditions in the market for competitive products and the degree to which the field of competition appears level for both the Postal Service and its competitors. Finally, pursuant to the directive in section 703 of the PAEA,[2] the Public Representative has considered changes in laws since the 2007 FTC Report that was required by the PAEA concerning the laws that favor either the Postal Service or its competitors.[3]

For the reasons discussed below, the Public Representative believes the Commission should retain the current 5.5 percent requirement.

III. BACKGROUND

A. Commission Order Nos. 26, 43 and 1449

Existing 5.5 Percent Policy. In 2007, pursuant to section 3633(a)(3), the Commission proposed new regulations at 39 C.F.R. 3015.7 to ensure that "all competitive products collectively" cover, at a minimum, 5.5 percent of total institutional

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[2] Uncodified section 703 of the PAEA requires the Commission, when revising its regulations pursuant to section 3633, to consider the net effect of changes in laws since the FTC's 2007 Report that affect the Postal Service and others differently. For ready reference, section 703 appears in the notes immediately following 39 U.S.C.A. § 3633.

[3] Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors, A Report by the Federal Trade Commission, December 2007 (FTC Report).

costs. Order No. 26 at 71.[4] That policy was implemented by Order No. 43.[5] After five years, the Commission reviewed its regulation and maintained the appropriate share requirement of 5.5 percent in its current form.[6] In this proceeding, the Commission is again undertaking the required five year review. The 5 year review requirement of section 3633(b) is unambiguous. The Commission is to review whether the appropriate share of the institutional cost contribution requirement to be collected from competitive products collectively "under subsection 3633(a)(3) should be retained in its *current form, modified, or eliminated*." (Emphasis supplied.) 39 U.S.C. § 3633(b).

IV. COMMENTS

A. A Reasoned Explanation Is Required to Alter the Current 5.5 Percent Policy

A Commission determination to alter the 5.5 percent requirement will require a reasoned explanation for rejecting the current 5.5 percent policy. The current regulation at 39 C.F.R. § 3015.7(c) states that the requirement is "5.5 percent of the Postal Service's total institutional costs." The Commission's policy is explicit and clear. In this proceeding, the Commission may choose to alter the current policy as it finds appropriate, but any modification of the current policy requires not only reasons for the new policy, but the Commission must explain and offer explicit reasons why the current policy is no longer sufficient and that a change in course is warranted. *See Hatch v. FERC*, 654 F.2d 825, 834 (D.C. Cir. 1981); *USPS v. PRC*, D.C. Cir., No. 15-1338, December 6, 2016 at 4.

B. Some Factors the Commission Considers Remain Constant, While Other Factors May Change

The Commission has twice addressed this issue and each review has determined that 5.5 percent is the appropriate contribution share to be borne by

[4] Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007 (Order No. 26).

[5] Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007 (Order No. 43).

[6] Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August, 23, 2012 (Order No. 1449) at 27.

competitive products. Upon each review, the Commission expressed its reasoning in reaching the 5.5 percent. Many of those reasons remain constant. Other new relevant factors may have arisen since those reviews or may not have been relevant at the time of the previous reviews. Additionally, other mandatory market related factors to be considered pursuant to statute are fluid and must be revisited during each review, such as the § 3633(b) requirement that the Commission include among its consideration of all relevant circumstances, "the *prevailing* competitive conditions in the market." (Emphasis supplied.) Competitive conditions can and do change. Below, the Public Representative reviews the competitive conditions in today's market.

There is also another factor to consider that was subject to change in the intervening five years since the last Commission review in 2012. The Commission is required by section 703 of the PAEA to "take into account" when revising or modifying regulations under section 3633, as it might here, the "subsequent events that affect the continuing validity of the [FTC Report's] estimate of the net economic effect" of "Federal and State law that apply differently to the United States Postal Service with respect to the competitive category of mail…and to private companies providing similar products." PAEA at §§ 703(d), 703(a). The Public Representative also discusses this factor, below. Unless market conditions or new events or relevant factors not previously considered have occurred that alter the balance previously drawn by the Commission, the 5.5 percent should be retained.

C. Commission's Reasons for Current 5.5 Percent Contribution Requirement

The original reasons for 5.5 percent as the appropriate share were laid out in the 2007 Commission orders:

Rejected methodologies. As a first step in Order No. 26 in 2007, the Commission recognized that the "appropriate share" is not defined in the PAEA and that it left the appropriate share for the Commission to determine "based on consideration of all relevant factors." Order No. 26 at 69.

The legislative history of the PAEA in the House of Representatives includes a predecessor bill, H.R. 4341, which sheds some light on the manner the appropriate share was to be determined by the Commission, *i.e.* with some flexibility. The House Committee Report on that bill is instructive about Congress' intention regarding the Commission's determination of the appropriate contribution standard.[7] H.R. 4341 contained a provision in section 3633 comparable to section 3633(a)(3) that was later passed in the PAEA.

The earlier proposed bill provided that the Commission's regulations were to ensure all competitive products collectively make a "reasonable contribution" to institutional costs rather than collectively cover "an appropriate share" of institutional costs as provided in current section 3633(a)(3). H.R. 4341 Report at 86. That language differed slightly from the current section 3633(a)(3), but because of the similarity of approach, the underlying intent of the section can fairly serve as guidance. The H.R. 4341 Report stated that, "With respect to the requirement that competitive products collectively make a reasonable contribution to overhead, it should be noted that the broad standard contains *inherent flexibility*. It is not intended to dictate a particular approach that the Postal Regulatory Commission should follow." (Emphasis supplied.) H.R. 4341 Report at 8. Thus, although the earlier standard was revised from "reasonable contribution" to "appropriate share," it is fair to conclude the drafters did not intend for the Commission to follow a particular approach when establishing the contribution standard.

Several methodologies suggested by participants were rejected by the Commission in Order No. 26. Specifically, the methodologies considered but rejected would be based on a comparison of contributions from market dominant and competitive products. The comparison might be on an equal per-piece (unit contribution) basis or equal percentage (markup) basis such as a markup on the sum of competitive products' attributable cost. Also suggested and rejected was a markup of

[7] *See* Report of House Committee on Government Reform to Accompany H.R. 4341, Postal Accountability and Enhancement Act, 108th Congress, Rept. 108-672, Part 1, September 8, 2004 (H.R. 4341 Report).

competitive product's attributable costs and percentage of revenues. Order No. 26 at 69-70. The Commission did not reconsider those rejected methodologies when issuing its final regulations on the matter. *See* Order No.43 at 91-92. Those alternative methodologies were not considered five years later in Order No. 1449. There is no reason here to reconsider those rejected methodologies.

Reasons for current methodology. The current methodology that bases the appropriate share upon the percentage of total institutional costs was chosen for several reasons. The following reasons supporting the 5.5 percent are factors that remain constant and so are unchanged since 2007:

1. The method does not imply a pricing technique; *e.g*., a particular coverage level, Order No. 26 at 70;

2. The method is more easily understood, *Id*.; and

3. Differences in the rate-setting process under the PRA and the PAEA enable a lower contribution requirement. *Id.* at 71.

As for the third factor above, Order No. 26 explained that the "appropriate share" is not synonymous with "reasonably assignable" under the PRA § 3622(b)(3). Under the PRA, rate levels equated with maximum rates for the subclass or type of mail and were not designed to generate a surplus. *Id*. at 72. Appropriate share under the PAEA is now a "floor" for all competitive products; thus it is not a maximum contribution level. But, because earnings may be retained, the Postal Service has an incentive to exceed the threshold floor, including reducing rate pressure on market dominant rates, continuation of universal service and a possibility of bonuses. *Id*. The new incentive of the Postal Service to exceed the floor reduces the need to mandate a higher level of contribution.

The appropriate share was also set below the 6.9 percent share of total institutional costs, the estimate of the contribution that competitive products would provide for the next test year, TY 2008. *Id.* at 70-1.

Two other factors that the Commission said might have provided a basis for revising the 5.5 percent policy established in Order No. 26 have come and gone. They were: 1. the then forthcoming Treasury Department recommendation regarding tax treatments, and 2. the fact that the PAEA had established a new system for regulating rates. Each of those factors might have become relevant in the five years between Order No. 26 and Order No. 1449, and could have led to a revision of the 5.5 percent policy in 2012. However, after Commission review in 2012, those factors did not lead to a change in the appropriate share policy. At this time, for this third assessment, the Treasury Report and the newness of the regulatory changes have faded and so those factors are obsolete as considerations underlying the appropriate share determination.[8]

With the basic reasons supporting the methodology applied in 2007 being constant, and two other factors, now outdated, that might have warranted changes to the 5.5 percent, there remains only variable market considerations for the Commission to weigh in reaching the 5.5 percent figure. The following market factors previously considered and included in the 5.5 percent decision remain relevant to the Commission's determination.

- *Risk of setting the minimum contribution too high.* In Order No. 26, the Commission said that the market for competitive products was competitive, the Postal Service's market share was "relatively small," and the Postal Service needed some *flexibility to compete*. The appropriate share was set below the estimated 6.9 percent share of total institutional costs that competitive products were expected to provide for the next test year, TY2008. Order No. 26 at 70-1. Thus, the percentage share of earnings was reduced from the estimated 6.9 percent level to 5.5 percent. Later, in Order No. 1449 the Commission found no reason to modify its conclusions.

[8] Order No. 26 suggested that interested persons' might comment on forthcoming Treasury recommendations to be issued after Order No. 26 as they related to the 5.5 percent policy. Order No. 26 at 74 n. 65. Before the second review occurred in 2012, the Treasury had by then published its recommendation relating to treatment of Postal Service costs. To the extent there were any such comments, they did not cause alteration of the 5.5 percent policy in the second review. No. 26 also cited the risk of setting the appropriate contribution too high, "particularly at the outset of a new system of regulation." *Id.* at 73. The onset of a new system of regulation is now past, although the risk of setting the contribution too high remains a continuing consideration.

- *Changing levels of market competition*. The market analysis discussion below considers for the period since Order No. 1449: 1. Whether there have been *changes in the level of competition in the market*, and 2. The Postal Service's *current share of the market* with respect to competitive products.

- *Risk of setting the contribution too low*. If the required contribution is set too low, the Postal Service would have a competitive advantage. *Id.* at 73. On review in 2012, the Commission determined there was a lack of evidence that the Postal Service had a *competitive advantage* over its competitors. This lack of evidence supported the conclusion the 5.5 percent minimum is not too low. Order No. 1449 at 16. The current state of the Postal Service's competitive advantage is discussed below.

- *Historic results*. Setting the contribution at historic levels is "a reasonable means to quantify appropriate share." Order No. 26 at 74. In Order No. 1449, the Commission reviewed competitive product contributions for 2007 through 2011. Order No. 1449 at 19-21. The percentage share of institutional costs covered by competitive products fluctuated within a relatively small range of 5.54 percent to 7.82 percent in dollar terms, but the competitive contribution to institutional costs soared by 29 percent between FY 2007 and FY 2011. *Id*. at 20-21. The Commission concluded that it appeared the 5.5 percent had not hampered the Postal Service in pricing its competitive products. If anything, the contributions for the five years FY 2012 through FY2016 were significantly better. Chart I and Table I, below, show the steady increases in contribution from 2007 through 2016. Consistent with this, the contribution share has also increased accordingly as shown on Table I. From this data is it clear that the 5.5 percent requirement has not hampered the Postal Service's pricing.

Chart I

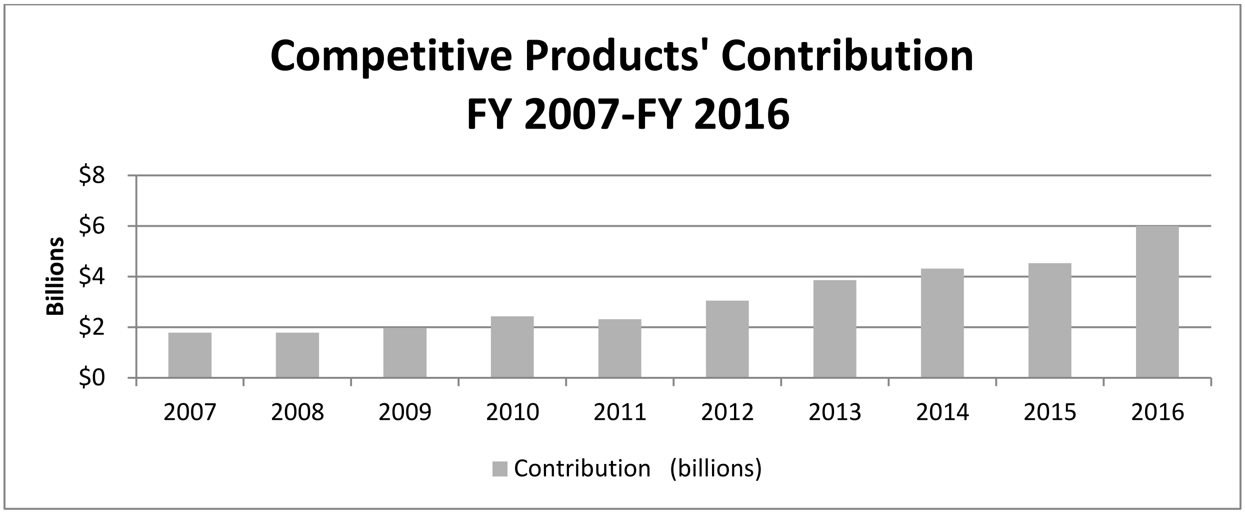

Table I

Competitive Products' Contribution to Institutional Costs	
Fiscal Year	Contribution (billions)
2007	$1.786
2008	$1.782
2009	$1.960
2010	$2.420
2011	$2.310
2012	$3.042
2013	$3.860
2014	$4.309
2015	$4.523
2016	$5.997

Source: PRC ACD Reports

- *Other Factors.* The Commission said that the contribution level may be changed for additions or deletions to the competition product lists and market conditions. *Id*. Later in Order No. 1449, the Commission discussed changing competitive product lists and market conditions. In this proceeding, the Commission should again consider changes in the competitive product lists and market conditions since the review in Order No. 1449. The Public representative discusses these issues, below.

Order No. 1449 also noted that proposed Postal Service changes in its delivery standards and its processing network, as well as the difficult financial condition of the Postal Service, could, taken together, potentially alter the relationship of attributable costs to institutional costs which, in turn, could affect the appropriate share percentage in the future. Order No. 1449 at 23-4. Uncertainties continue; the Postal Service is planning to move ahead with Phase 2 with changes to its processing network and potential legislation continues to loom in Congress that would impact the Postal Service's financial condition. Unless these factors come to fruition, they cannot lend support to any modification of the current 5.5 percent share.

In Order No. 1449, the Commission noted that the FTC Report found Federally-imposed restraints on the Postal Service increased its costs and placed the Postal Service at a competitive disadvantage. Order No. 1449 at 14-5. The Commission found that there was no evidence of predatory pricing, noting the PAEA requires that competitive products must be priced above attributable cost. *Id*. at 15. Nor had competitors filed an anti-trust complaint alleging that the Postal Service had engaged in predatory pricing of its competitive products. *Id*. at 18.

The Commission said that the 5.5 share also provides another way of leveling the playing field for competitive products and provides protection for the Postal Service's competitors from unfair or anti-competitive pricing because the 5.5 percent policy requires prices to recover some fixed costs. *Id.* The Public Representative discusses these issues, below.

D. Current Market Assessment

Section 3633(b) explicitly requires the Commission to take into consideration the "prevailing conditions in the market" in determining whether to retain, modify, or eliminate the appropriate share contribution level for competitive products. 39 U.S.C. § 3633(b). As the Commission did in its FY2012 review of the appropriate level of contribution by competitive products, the Public Representative has reviewed three prevailing conditions in the market that are relevant to the appropriate share analysis. The prevailing conditions addressed are the 1. *industry structure*, 2. *conduct of the participants* in the industry, and 3. *results of that conduct* (performance) on the part of the participants.[9]

1. Market Structure

The structure of the market for the Postal Service's competitive products is highly concentrated with very unequal participant market shares. UPS and FedEx are the dominant participants accounting for nearly 84 percent, by volume, of the market and the Postal Service accounts for a much smaller 15 percent share. While barriers to entry could be categorized as low, entry and progression to an efficient, profitable scale, is relatively difficult.

The market for competitive products features several submarkets categorized largely on service performance standards including air express, 2-3 day air/ ground markets and 3-5 day ground markets. These submarkets, in fact, overlap to a degree. The delivery chain consists of an upstream portion featuring the collection, processing and transportation functions, while the downstream portion consists of the so-called "last-mile." Not only do these markets overlap to some degree, but the market participants themselves are involved in multiple interactions such as FedEx engaging in air transportation on behalf of the Postal Service and the Postal Service, in turn, performing "last-mile" deliveries for both UPS and FedEx. Furthermore, the ascendency

[9] For a more detailed description of this paradigm, *see* F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance*, Houghton Mifflin Company, 1990, at. 5.

of a vertically integrated Amazon has introduced both an element of buyer power and the potential of logistic/shipping competition.

Section 703 of the PAEA. The market structure's playing field may also need to be considered in terms of the impact on the competitive playing field if the 5.5 percent share is modified.[10] Uncodified Section 703(d) of the PAEA provides the Commission an explicit and continuing statutory responsibility when revising its regulations under section 3633 that it "shall take into account…subsequent events [after the Federal Trade Commission Report] that affect the continuing validity of the estimate of the net economic effect" of federal laws that apply differently to the Postal Service and to represents Congress' effort to encourage and maintain a level playing field in the markets where the Postal Service and its competitors compete.

Certain events affecting the postal markets have occurred since the FTC report. Transfers of various mail services to the competitive product list following passage of the PAEA and the FTC report represent changes in federal law that have impacted the net economic effect of the laws that serve to treat the Postal Service differently than at the time of the FTC Report.[11] Since the FTC Report in 2007, several parcel products or their predecessors have been transferred from the market dominant to the competitive product list: *i.e*., Commercial Standard Mail Parcels (Order No. 689, March 2, 2011), Commercial First-Class Mail Parcels (Order No. 710, April 6, 2011), Parcel Post (Order No. 1411, July 20, 2012) and Inbound Surface Parcel Post (at Universal Postal Union

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[10] The requirements of section 703 and its application to revisions of the Commission's regulations under section 3633 were discussed at length by a Public Representative in the proceeding on UPS Proposals. See Docket No. RM2016-2, Public Representative Comments, January 27, 2016 at 15-20, 43-50.

[11] The Senate Report stated: The Committee recognizes that the Postal Service may enjoy other advantages in the competitive product market that are not addressed in this legislation. For this reason, we require in section 703 that the Federal Trade Commission submit a report to the President, Congress and the Postal Regulatory Commission within one year of the enactment of this Act identifying any federal and state laws that apply differently to the Postal Service than they do to the Postal Service's private sector competitors. If any discriminatory laws are identified, the Trade Commission's report will include recommendations for either ending the discrimination or accounting for them in some way through the rates the Postal Service charges for its competitive products. The Regulatory Commission will take the Trade Commission's recommendations into account when revising the regulations on rates for competitive products required under section 3633 of title 39." S. Rep. No. 108-318 at 29.

(UPU) rates (Order No. 2160, August 19, 2014).[12] The impact of the price cap on that transferred mail has been eliminated, thus to some degree changing the net effect of federal law treating the Postal Service differently than other companies and thereby further changing the playing field for competitive products. The Postal Service can compete more directly with its competitors without price constraints on those transferred products.

The FTC Report suggested Congress may wish to consider reducing constraints on the Postal Service's competitive operations. FTC Report at 9. The FTC did not discuss potential advantages of adjusting federal law at the Commission (agency) level by transferring market dominant products to the competitive product list. However, because of the recent transfers, price constraints have been lifted, thereby significantly altering the market structure. Because these product transfers permit increased prices for transferred products, the playing field has been further leveled by the Postal Service's ability to maximize its prices for these competitive products. There is no indication that the playing field needs to be further leveled by modification of the 5.5 percent contribution requirement.

2. Conduct of the Market Participants

Competition in the markets for package deliveries occurs based on relative prices and service performance and also on product features such as tracking capability. There is also a dual price structure in that many customers of all of the delivery companies enjoy benefits from customized rates not applicable to all buyers. FedEx and UPS also feature a variety of surcharges such as fuel surcharges and rural delivery surcharges. In many instances, shippers typically utilize only one shipper despite the existence of other alternative shippers. It also appears that shipping contracts are typically renegotiated only yearly.[13] This occurs due to the existence of longer-term planning horizons and because changing shippers incurs a form of "switching costs".[14]

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[12] PRC, *Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006*, November 14, 2016 at 12-13.

[13] Rob Martinez, *2015 Parcel Pricing & Benchmarking Survey: Live Parcel Forum Results Unveiled*.

The interaction between market structure and market conduct affects the market shares of its participants. Market share analyses presented in Commission Docket No. RM2016-2 appear to indicate that the relative shares of the markets described above have been relatively stable for some years although precise comparisons are complicated.[15] Analytically, the absolute level and stability of market shares as well as measures of profitability are telltale indicators of the competitive conditions existing in the parcel delivery industry. Even as simple as these metrics appear, they can be obscured by large changes in macro factors such as those described below. A rapidly rising market can cause increased profits even with no change in market shares on the assumption that all participants claim at least some share of overall market increases. On the other hand, in a declining market, the only way to maintain delivery volumes is to take volumes from competitors, *i.e*., an increase in market share.

In Order No. 1449, the Commission found that the lack of a significant increase in market share, either by volume or by revenue over the period 2006-2011, minimized concerns of Postal Service artificial advantage over its competitors. Order No. 1449 at 18. The market share over the period 2001-2016 has not changed significantly.

3. Market Performance

In Order No. 1449, the delivery market volume was expected to expand by about 40 percent between 2009 and 2020. One competitor, DHL Express, with an estimated 3 to 4 percent of the market share for domestic ground and air shipping in the United States ended its ground and air operations in 2009. Order No. 1449 at 18-9. The opportunity to expand competitive services allowed the Postal Service's competitive product pricing to produce contributions exceeding 5.5 percent. Nevertheless, these circumstances did not provide the Postal Service with an unfair competitive advantage or affect the share requirement. *Id*. at 19.

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[14] Jeffery Church and Roger Ware, *Industrial Organization, A Strategic Approach*, Irwin McGraw-Hill, 2000, at 121, 546-549.

[15] Docket No. RM2016-2, Initial Comments of the United States Postal Service on UPS Proposals One and Two, January 25, 2016 at 37-45

Since the Commission last visited this subject in Order No. 1449 in 2012, there have been some significant changes in the parcel delivery industry. First, there has been a rapid acceleration in the overall growth of the market due to both the ongoing recovery from the recession of 2009 and the continually increasing share of online purchases as a percent of the total market. The overall share of e-commerce, as a percent total of retail sales, has nearly doubled since 2006 according to U.S. Census Bureau data.[16] It has also been reported that estimated e-commerce spending jumped 19 percent during the recent holidays, compared with an overall 4 percent increase in retail spending.[17] The Wall Street Journal reported that UPS expected to handle 700 million packages between Thanksgiving and the end of December, 2016, up 14 percent from last year's all-time high. FedEx expected a 10 percent increase. UPS notes that growth in U.S. online sales is estimated to nearly double by 2020.[18] Second, the meteoric rise of the Amazon companies has created a powerful buyer of parcel delivery services. The Wall Street Journal recently reported that Amazon's share of online retail sales grew to 40 percent during the critical November/December Holiday Shopping period.[19] It also appears that Amazon may be developing a significant logistical system of its own, including end-to-end delivery capability, although much of that delivery capacity might be needed to support Amazon products with even less than two-day delivery windows. Finally, against this backdrop, the Postal Service's financial condition continues to be precarious.

The transfer of Postal Service products to the competitive list is not significant in terms of immediate impact on market shares. In Order No. 1449, the Commission recognized the transfer of products to the competitive product list increased revenue by 55.8 percent and increased competitive volume by 21.4 percent. Order No. 1449 at 22. It also recognized that in Order No. 26 the transfer of products to the competitive list was mentioned as a potential reason to modify the appropriate share requirement. *Id.*

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[16] U.S. Census Bureau: Quarterly E-Commerce Report.

[17] "Macy's and Kohl's are Hit by Weak Holiday Sales," Wall Street Journal, January 5, 2017.

[18] United Parcel Service, SEC Form 10-K, December 31, 2015 at 6.

[19] "Retailers Make 11th-Hour Push to Lure Last-Minute Shoppers", Wall Street Journal, January 3, 2017.

at 21. However, the competitive product volume compared to total volume overall remained relatively constant from 2007 to 2010 at 0.8 percent, and increased to only 0.9 percent in 2011. Even with the then recent transfer of commercial First-Class Mail parcels and commercial Standard Mail Parcels, that volume was preliminarily estimated to increase to only 1.6 percent of total Postal Service FY 2012 volume. *Id*. at 22. The Commission concluded that competitive product expansion from whichever source, market or product transfer, is not related to the appropriate share requirement, noting institutional costs do not, by definition, vary with volume. *Id*. at 23.

However, the Commission noted in Order No. 1449 that if competitive volumes substantially increased relative to market dominant volume, a change in the share level could be considered in the right circumstances. *Id*. In the intervening period since Order No. 1449, the competitive volumes have not substantially increased relative to market dominant volume. Competitive products' share of total Postal Service volumes has increased steadily since 2012. By FY 2015, Competitive product's share of total volumes had increased to nearly 2.6 percent, largely due to the rapid expansion of Parcel Select volumes. However, this remains a relatively minor share of the Postal Service's mail volume. These changes do not suggest a basis for modifying the current 5.5 percent requirement.

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Profits. Another factor to consider is the profits derived by each of the major market participants.[20] Even before the recent strong demand for parcel delivery service and the anticipated future surge, UPS and FedEx profits in 2014 and 2015 indicate that they have been very much able to compete in the marketplace and to earn substantial profits at a rate far greater than the Postal Service. For instance, UPS's after tax income for 2015 was $4.844 billion on total revenue of $58.363 billion. Its 2014 after tax net income was $3.032 billion on total revenue of $58.232 billion. Domestically, in 2015, UPS's package revenue totaled $36.747 billion, slightly more than its 2014

[20] The following discussion of competitors' profits draws from similar comments of the Public Representative in Docket No. RM2016-2, Public Representative Comments, January 27, 2016 at 51-52.

revenue of $35.851 billion.[21] These substantial profits on revenue indicate that UPS was able to compete with the Postal Service in 2014 and 2015 and earned substantially more than the Postal Service on revenue that was about 20 percent lower than the Postal Service's revenue.

Similarly, FedEx was also able to earn substantial profits during that same period. Its net income after taxes for FY 2016 was $1.820 billion on total revenues of $50.365 billion. FedEx's FY 2015 net income after taxes was $1.050 billion on total revenues of $47.453 billion.[22] FedEx's operations are segmented. Most relevant for the Postal Service are the FedEx Express and FedEx Ground segments where the Express segment had revenues of 11.804 billion and the Ground segment had revenues in 2016 of about $16.574 billion. The FedEx Express segment enjoyed operating income of $2.519 billion in 2016 and the Ground segment had operating income of $2.276 billion in 2016.[23] While FedEx Express revenues were flat in 2016, FedEx ground segment revenues increased 28 percent in 2016 due to both volume and yield growth.[24]

These profit figures indicate healthy, highly profitable, business rivals in competition with the Postal Service.[25] There is no evidence from these profit accounts regarding lost market shares reducing profits or of unfair competition tilting the playing field. Any such potential concerns are not borne out by the actual results of their operations.

Moreover, Commission ordered increases in the appropriate share that might force Postal Service price increases to ensure that it meets the appropriate share regulation may simply fuel industry-wide across-the-board price increases for those products where competition is alive and well.

[21] UPS Form 10-K, U.S. Securities and Exchange Commission, December 31, 2015 at 22.

[22] FedEx Form 10-K, U.S. Securities and Exchange Commission, Fiscal Year ended May 31, 2016, at 11.

[23] *Id*. at 22, 25.

[24] *Id*.

[25] For an explanation of the distinction between the terms "rivalry" and "competition", see F.M. Scherer and David Ross, *supra* at 16-17.

V. RECOMMENDATION

The Public Representative believes that when taking into account the conditions existing in the Parcel Shipping Industry, the Postal Service's precarious financial situation, and the trends expected during the next five year period, particularly when balanced with other factors previously considered relevant by the Commission, it would be unwise at this time for the Commission to take any action to raise the minimum contribution level currently in effect for competitive products.

Under the current industry structure, there is no assurance that any action which might cause the Postal Service to raise its competitive prices will benefit anyone other than the current industry participants whose own rates may be able to track any upward movement in Postal Service rates, and who, by most measures, are quite profitable.

The competitors' package volumes are growing to such an extent that published reports indicate their meeting peak Christmas season deliveries posed increasing challenges. In contrast, the Postal Service's much less stable financial condition will tend to encourage the Postal Service to maximize its revenues from parcel deliveries, even absent any new rule on the part of the Commission raising the percentage share of contribution. In order for the Postal Service to underprice its rivals to gain market share, thus reducing revenues in the process, an adequate stream of revenues would be required in the first place. This is problematic in the case of the Postal Service. It also should be noted that there is simply too little margin for error in the Postal Service's pricing of competitive products to risk promulgating a codified minimum contribution level that might be too high and cause a loss of otherwise profitable volumes of competitive products. In this way, the Public Representative echoes the concerns of another Public Representative previously expressed in Docket No. RM2012-3 concerning the risk to the Postal Service of overpricing its competitive products.[26] Furthermore, it would be unwise of the Postal Service to adjust competitive prices too frequently in an effort to maximize revenues from competitive products as advocated by some, since this would cause an increased level of uncertainty with its customers.

[26] PRC Docket No. RM2012-3, Comments of the Public Representative in Response to Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 9, 2012 at 4.

VI. CONCLUSION

The Public Representative submits the foregoing comments for the Commission's consideration.

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